

**TESTIMONY OF MICHAEL J. MASSEY
SENIOR VICE PRESIDENT AND GENERAL COUNSEL
PAYLESS SHOESOURCE, INC.**

BEFORE THE

**SUBCOMMITTEE ON THE WESTERN HEMISPHERE,
HOUSE INTERNATIONAL RELATIONS COMMITTEE**

REGARDING

**THE U.S. FREE TRADE AGREEMENT WITH CENTRAL AMERICA AND
THE DOMINICAN REPUBLIC ("DR-CAFTA")**

April 13, 2005

Mr. Chairman and Members of the Committee, thank you for allowing me to appear before you today. My name is Michael J. Massey and I am Senior Vice President - General Counsel and Secretary for Payless ShoeSource. I am also Chairman of Payless ShoeSource BVI Holdings, Ltd., Payless' joint venture company operating 136 stores in the Central American region. I wish to express our strong support for DR-CAFTA, the Free Trade Agreement among the United States, the five Central American countries of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, and the Dominican Republic.

Payless is the Western Hemisphere's largest family footwear retailer generating almost \$2.77 billion dollars in sales in 2004. We have nearly 4,700 retail stores in all fifty U.S. states, Canada, the Caribbean, and Central America. These stores are located in a variety of settings, from urban to rural. In addition, through a joint venture agreement with the Japanese trading company, Sojitz, we operate one store in Japan.

Payless employs nearly 27,000 associates in the United States alone. Our world headquarters is located in Topeka, Kansas. We transport approximately 60 percent of our product to our main distribution center in Topeka,. From there the goods are sorted and re-distributed to one of 50 smaller distribution centers throughout the United States and then on to Payless' retail stores.

Payless clears an average of 22,000 forty-foot containers through U.S. ports of entry each year, and the declared value of our total imports in a typical year averages between \$900 million dollars and \$1 billion dollars. We pay approximately \$95 million dollars annually in duties to the United States.

Payless has been a global enterprise for many years. We are able to offer our customers a unique combination of quality footwear at prices they can afford, in large part, due to our extensive long-term relationships with overseas footwear producers. Accordingly, Payless has long taken a keen interest in U.S. foreign and trade policy and we are a consistent advocate of free trade.

In recent years, we have begun to expand our retail presence throughout the Western Hemisphere. In 1997, Payless opened the first of its now nearly 300 Canadian stores. We began our expansion into Latin America in November of 2000 when we opened the first Payless store in Costa Rica. Since then, Payless has, through a Central American partnership, opened stores in El Salvador, Honduras, Guatemala, Nicaragua, Panama, the

Dominican Republic, and Trinidad and Tobago. In South America, Payless, through another Latin American partnership, operates 30 stores in Ecuador. We have found the Latin American customer very receptive to our in-store presentation and product mix and have, in general, enjoyed success in these markets.

We believe DR-CAFTA will benefit U.S. exporters by opening markets across the region to their products and protecting their investments and intellectual property rights. In addition, these trade agreements will provide opportunities for economic growth in Central America and the Dominican Republic and will help promote political stability throughout the region. By opening and operating 136 stores across the region, Payless has made a substantial investment with its retail presence throughout Central America. Those stores as a whole account for nearly \$70 million in gross sales. Thus, Payless is directly impacted by the economic and social well-being of the people of Central America. Naturally, we are enthusiastic champions of any legislation which has the effect of improving our customers' lives and their buying power. DR-CAFTA represents an important step along the road toward more liberalized trade throughout the Western Hemisphere and Payless ShoeSource has long believed that free trade generally benefits all participants.

The Central American apparel industry has been recently reported as a good illustration of the relationship between the U.S. economy and the economies of Central America. Throughout Central America there are an estimated 1,000 textile and apparel factories that employ some 500,000 people. Apparel makers in the Dominican Republic and

Central America face stiff competition from abroad, especially since the ending of U.S. textile quotas. Many apparel factories in Central America, both as buyers and sellers, are staking their futures on these trade agreements, to ensure U.S.-made fabric and yarn is brought into their countries duty-free and then, after assembly, exported back to the U.S. duty free. Unless their access to the U.S. markets is kept open by the DR-CAFTA, apparel factories in the region will be unable to compete in a global market and will be forced to shut down. Thousands of Payless' customers will be out of work, negatively impacting our Central American business. And it is widely predicted that many won't stay in their home countries hoping the factories reopen, but will pursue better perceived opportunities here in the United States. In addition, without the DR-CAFTA the U.S. textile industry will lose one of its largest customers – the apparel industry in the Dominican Republic and Central America.

Payless also supports DR-CAFTA for reasons which are more specific to our long-term vision as the Western Hemisphere's largest footwear retailer. We are always on the lookout for opportunities to diversify our sourcing base and to using producers from parts of the World other than Asia. The Company already sources some products from Brazil, Colombia, and the Dominican Republic. Increased production from Latin America could be an important potential element of our future sourcing base and we believe DR-CAFTA could facilitate the growth of the footwear industry in Central America.

The DR-CAFTA allows immediate duty-free treatment for most types of footwear originating in the DR-CAFTA member countries. This duty-free treatment applies to

some 98 of the 115 tariff classifications for footwear. A carefully crafted list of 17 shoe types is excluded from instant duty-free treatment because they are still produced in the United States. Instead, the duties on these footwear types are to be phased-out over a period of time.

The DR-CAFTA is critical if footwear producers in Central America are to develop into world-class competitors. Several provisions in the DR-CAFTA are important in this regard including the rule of origin. The DR-CAFTA contains a substantial transformation rule of origin. A footwear component is brought into a member country under one tariff classification and then assembled with another component. The final shoe is then exported under a different classification. Because the product has been substantially transformed, it is considered to have originated in that country.

A more stringent rule of origin would require local factories to construct most of the shoe with components from the member country. At present, Central America does not have the industrial infrastructure to support large scale shoe manufacturing. In fact, there are no factories in the region which can construct shoes from start to finish at the volumes and costs Payless requires.

The transformation rule of origin could allow smaller existing factories or new larger foreign joint-venture assembly factories to import components and assemble them in the DR-CAFTA countries, thereby creating the basis for a growing footwear manufacturing infrastructure. Once robust assembly operations are up and running, it stands to reason

that in-country market forces will lead to the development of broader factory operations and the development of a regional raw material and component supplier infrastructure, as has occurred in other countries. Ultimately, it is possible that the entire shoe could be built from component materials manufactured in the Western Hemisphere, including from suppliers in the United States. Such development would almost certainly not occur without the substantial transformation rule of origin.

Payless believes the footwear provisions currently found in DR-CAFTA will be conducive to the development of footwear manufacturing here in our own Hemisphere. This will be good for the countries which produce the shoes, but it could also have benefits for the United States. Currently, when a shoe is manufactured in Asia, the only firms which have a realistic chance of competing to supply components for that shoe are other Asian firms. If production were occurring in this Hemisphere, U.S. firms would have an excellent opportunity to compete for that type of business. With DR-CAFTA, we could eventually see Central American shoes in our stores worldwide containing textile fabric, leather, shoe laces, eyelets and insoles produced in the United States.

The suggestion that increased manufacturing in Central America could benefit U.S. suppliers has already been amply proven by the textile industry. It has been reported that more than seventy percent of the garments made in Central America are produced from U.S. fabrics and yarn. DR-CAFTA will ensure that U.S. fabric and yarn suppliers can continue and possibly expand their exports to Central America, enabling Central

American manufacturers to expand their export markets and compete in a global economy. This is a win-win for U.S. producers and Central American manufacturers

However, U.S. suppliers are not the only ones to benefit from the DR-CAFTA in the United States. The increased market access accorded under the DR-CAFTA will also benefit U.S. consumers. Currently, high tariffs harm consumers by forcing them to pay higher prices on imported footwear. A reduction in trade barriers could drive down prices at both the factory and retail levels. A win-win situation for all.

Let me also say a few words about the current state of the Central American, Dominican Republic, and U.S. footwear industries. Not one of five Central American countries has a significant shoe manufacturing industry or meaningful exports of footwear. On the other hand, the Dominican Republic has some footwear production. In terms of market share though, it remains less than one percent of the total U.S. market. None of these industries pose any threat to U.S. footwear manufacturing jobs.

With regard to the United States, the market for footwear is fulfilled primarily through imports with only a small number of firms continuing to manufacture domestically. Total U.S. import penetration for all footwear is approximately 98%. This is astounding given that the average duties on footwear are among the highest of any product entering the United States.

The U.S. shoe industry, however, has carved-out its own niches in the marketplace which do not compete on price. As a result, there is no connection between the elimination of

duties and employment in the U.S. footwear industry. We have worked hard to ensure that there are no adverse domestic implications regarding the footwear provisions in the DR-CAFTA, and I believe we have achieved that. In fact, I believe DR-CAFTA will revitalize the footwear industry in this Hemisphere, ultimately creating opportunities for U.S. suppliers.

Payless, through various trade associations, worked extensively with other footwear retailers and the small number of firms which still produce footwear in the United States to provide input to the U.S. Trade Representative on the footwear provisions in DR-CAFTA. We were sensitive to the pressures facing the remaining U.S. footwear producers. Our objective was – and I am happy to say we were successful – to reach a consensus on developing economically viable rules of origin for footwear not produced in the United States. As a result of these efforts, the U.S. Trade Representative negotiated footwear provisions in DR-CAFTA that are a win-win for U.S. consumers, footwear retailers, other U.S. businesses, and the countries of Central America and the Dominican Republic.

For these reasons, I ask you, Mr. Chairman and Members of the Committee, to recognize the numerous benefits of the DR-CAFTA and vote in favor of it. This agreement will make the region more prosperous and stable, benefiting U.S. business and enhancing our national security.

Thank you, Mr. Chairman and Members of the Committee, for allowing me to testify before you today.

NOTE: Payless ShoeSource, Inc. has received no money from the Federal Government.